EARTHCHECK RESEARCH INSTITUTE

ESG Reporting What does it mean?

OCTOBER 2023

Belmond La Residence d'Angkor, Cambodia

Foreword

It is beyond question that the world needs to change and the corporate world needs to be a part of that change.

The extraordinary growth and development of Environmental, Social and Governance reporting is evidence of corporations becoming more involved in, and accountable for their impacts. As major global industries, tourism and hospitality need to be part of these changes.

Just as the efforts to become more sustainable are a contest of our values as much as a technical challenge, so the landscape of ESG is becoming more politicised. Yet, there is clear momentum to the need to devise ways in which organisations can understand the impact they are having, and the impact that will be had on them by changing environmental and social conditions.

There are considerable potential rewards for companies that can take account of a broader set of issues and report this in an honest, transparent and credible way. Recognising all the stakeholders of a business, not just shareholders, allows companies to become more resilient through giving consideration to employees, customers, suppliers, neighbours and the natural world. These have become pressing challenges and so forward-looking companies become more attractive to long-term investment.

This report seeks to explain what ESG is and to provide evidence about what ESG can do for organisations, along with the reasons for adopting a ESG framework against which to report.

This report does not attempt to explain the different ESG frameworks that are available, because, at the time of writing, there is such consolidation and shifts, that the material would be out of date before it was published. In light of these issues EarthCheck is building a specialised ESG team and examining the links between our sustainability reporting and metrics. Those interested in understanding more and deciding how to progress can reach out to this team.

If you haven't started already, now is the time to begin, the greatest risk is no action at all! It's time to galvanise your Green Team (or Sustainability Lead) to explore the options open to you.

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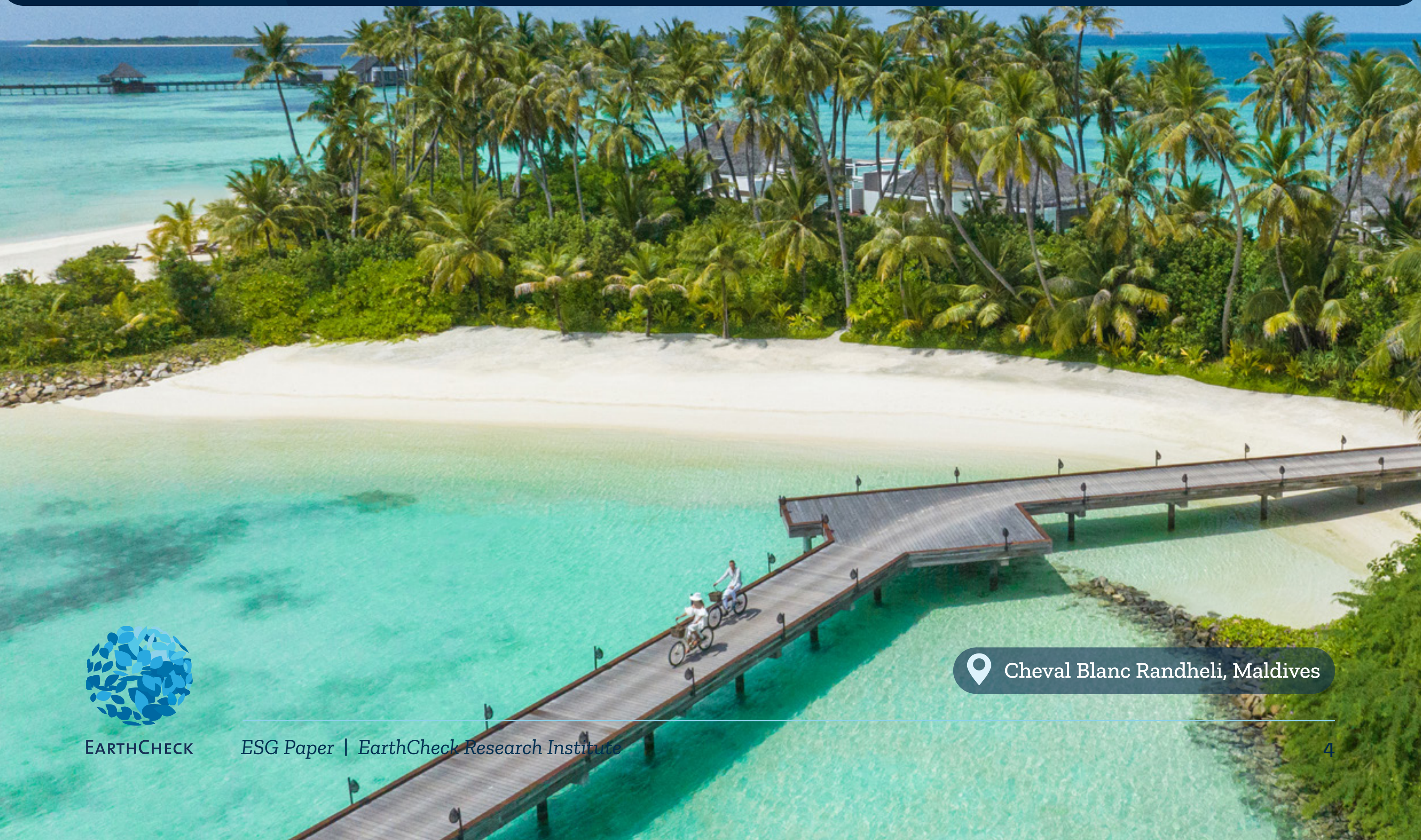
Banyan Tree Cabo Marqués, Mexico

Glossary

CBI	Confederation of British Industry
CSDDD	EU Corporate Sustainability Due Diligence Directive
CSR	Corporate Social Responsibility
CSRD	Corporate Sustainability Reporting Directive
CDSB	Climate Disclosures Standards Board
CSRD	Corporate Sustainability Reporting Directive
ESG	Economic, Social and Governance
ESRS	European Sustainability Reporting Standards
GRI	Global Reporting Initiative
IISB	International Sustainability Standards Board
IPCC	Intergovernmental Panel on Climate Change
ISO	International Organisation for Standardisation
NFRD	Non-Financial Reporting Directive
PRI	Principles for Responsible Investment
SASB	Sustainability Accounting Standards Board
SDG	United Nations Sustainable Development Goals
SEC	Securities and Exchange Commission
SFDR	Sustainable Finance Disclosure Regulation
TCFD	Taskforce on Climate-Related Disclosures



Cheval Blanc Randheli, Maldives

What is ESG?

ESG as a term was first used in a report from the International Finance Corporation in 2004 in response to calls from then UN General Secretary, Kofi Annan, to engage the private sector further with the challenges of securing a more sustainable world (IFC, 2004)[1].

At its most simple, ESG is a set of standards for measuring a firm's actions and risks under the headings (commonly referred to as pillars) of Environmental, Social and Governance. This takes the traditional concept of reporting financial performance and extends this much more widely into new areas of concern for society. ESG reporting is used by companies to explain their positive, and negative, impacts on a wide range of issues. Investors use ESG reports to analyse possible investments against a wider range of issues.

"The goal of ESG is to capture all the non-financial risks and opportunities inherent to a company's day-to-day activities" Deloitte (2023)[2].

ESG reporting has evolved from many different contexts and value sets, and as an emerging concept it presents a confusion of terms, standards, and objectives. There is a global drive to produce common standards. But, at the time of launching this report, the process is very much 'in progress' and the terrain is still messy and sometimes confusing. The pillars of ESG (Figure 1) are explored next.

Figure 1

ESP Pillars

Environmental pillar				Social pillar				Governance pillar	
Climate change	**Natural resources**	**Pollution & waste**	**Environment opportunity**	**Human capital**	**Product liability**	**Stakeholder opposition**	**Social opportunity**	**Corporate governance**	**Corporate behaviour**
Carbon emissions	Water stress	Toxic emission & waste	Opportunities in clean tech	Labour management	Product safety & quality	Controversial sourcing	Access to communication	Board diversity	Business ethics
Product carbon footprint	Biodiversity and land use	Packaging material & waste	Opportunities in green building	Health & safety	Chemical safety		Access to finance	Executive pay	Anti-competitive practices
Financial environmental impact	Raw material sourcing	Electronic waste	Opportunities in renewable energy	Human capital development	Financial product safety		Access to health care	Ownership	Corruption & instability
Climate charge vulnerability				Supply chain labor standards	Privacy & data security		Opportunities in nutrition & health	Accounting	Financial system instability
					Responsible investment				Tax transparency

Source PWC 2023[3]

1. IFC (2004) Who Cares Wins. https://documents1.worldbank.org/curated/en/444801491483640669/pdf/113850-BRI-IFC-Breif-whocares-PUBLIC.pdf Accessed 13th July, 2023
2. Deloitte (2023) What is ESG? https://www2.deloitte.com/hu/en/pages/energy-and-resources/articles/esg-explained-1-what-is-esg.html Accessed 29th June, 2023
3. PWC (2023) Environmental Social and Governance. What's it all about? https://www.pwc.com/mt/en/publications/sustainability/esg-what-is-it-all-about.html Accessed 19th July, 2023

Environmental consideration needs to be given to the product or services produced, the supply chain, and the operations of the company. It includes topics relevant to the organisation like:

- Energy usage and levels of renewable energy
- Carbon emissions
- Waste and packaging
- The nature of the product, service, or experience itself
- Whether a company uses virgin or recycled raw materials

Impact on biodiversity and deforestation will become increasingly important. Typically, this is the most complex pillar on which to report.

Social consideration relates to the way the business engages and impacts both within the organisation and externally with wider society. This might cover topics such as:

- Equality and fairness
- Labour rights
- Modern slavery
- Wellbeing, diversity and inclusion
- Investments in the local community

Sourcing from controversial markets may be relevant to this pillar, as might issues of accessibility for underprivileged groups.

Governance is internally focused on the way the organisation runs itself, makes decisions and reports. This focusses on transparency and honesty about its activities and wider ethical practices towards topics such as:

- Bribery and corruption
- Executive pay
- Accountability for performance and risk

Board diversity and executive remuneration are becoming increasingly prominent under this pillar.

Materiality and Double Materiality

Some issues are more relevant to organisations than others. Whether an issue is relevant to a company is referred to whether it is material or not.

Typically, materiality refers to what issues will have an impact (financial) on an organisation, whereas double materiality refers to what issues (social and environmental) the organisation will have an impact on.

Organisations are only expected to report on issues that are material. However, determining what is material can be complex and require discussion with stakeholders.

Legislative pressure:

Across a rapidly increasing proportion of the world, ESG reporting is becoming mandatory for large, listed entities.

In April 2021, the EU adopted the *Sustainable Finance Package* as an ambitious legislative plan to shift capital to sustainable investments, and in so doing meet its 2030 and 2050 Paris climate targets. The package includes the Corporate Sustainability Reporting Directive (CSRD), which is a widening of scope from the reporting requirements of the previous Non-Financial Reporting Directive (NFRD). From 2023 almost 50,000 companies in the EU will need to report on ESG issues. The US has proposed mandatory reporting on climate for listed companies from 2024. China published voluntary ESG reporting guidelines in 2016. Whilst there are no mandates in Australia yet, the federal government is consulting on mandatory ESG reporting by 2024-5.

In 2021, 95% of large organisations reported on ESG, with 64% obtaining some level of assurance or certification about the information provided. Initial reporting has tended to be concentrated around greenhouse gas measurement (IFAC, 2023[4]). By value, global ESG assets are on course to exceed US$53tn by 2025, accounting for more than a third of all assets under formal financial management (Bloomberg Intelligence, 2021[5]). The majority of these ESG assets are in Europe, but there is rapid growth across the US. Pandemic and green-recovery funds in Europe, US and China are likely to quicken the pace of investment into these funds.

Smaller organisations that are not of the size to be included directly in these legislative changes, will need to begin reporting because of the pressure from the larger companies to report on the behaviour of their whole supply chain. In this way, the pressure to adopt ESG as a reporting framework for non-financial impacts will become irresistible.

The **EU Corporate Sustainability Due Diligence Directive (CSDDD)** will require large companies to undertake due diligence on their own activities and that of their suppliers, and to identify and prevent, end or mitigate any actual or potential adverse impacts of their activities on human rights and on the environment.
Once the CSDDD has been formally adopted – not expected before 2024 – Member States will have two years to implement the CSDDD into national legislation.

4. International Federation of Accountants (2023) The State of Play: Sustainability Disclosure and Assurance 2019-2021 Trends and Analysis. https://ifacweb.blob.core.windows.net/publicfiles/2023-02/IFAC-State-of-Play-Sustainability-Assurance-Disclosures_0.pdf Accessed 19th July, 2023
5. Bloomberg Intelligence (2021) ESG 2021 Midyear Outlook report. https://www.bloomberg.com/professional/blog/esg-assets-may-hit-53-trillion-by-2025-a-third-of-global-aum/ Accessed 29th June, 2023

ESG reporting will require **large organisations** *to report on* **their whole of supply chain**. *Over time this will force organisations* **of all sizes** *to report.*

Grand Hotel Kempinski High Tatras, Slovakia

For whom is ESG important?

Shareholders

Under a traditional view of business, primarily the only people who matter to a company are shareholders. ESG reporting should provide greater assurance to shareholders of a wider set of risks and opportunities that could affect the value of their investment.

Investors

Future investors are also keen to know more than the information that can come just from the financial reports of a company. The value of assets invested in organisations with strong ESG performance are increasing significantly and the data are becoming an important way in which investment decisions are made.

Wider stakeholders

As we move to a world where organisations need to think about more than just their shareholders, and need to give due consideration to the wider stakeholders who affect, and are affected by, an organisation.

Employees

One of the highest levels of readership for company ESG and sustainability reports is the existing staff who are keen to understand the true impact of the organisation for which they work. Regardless of periods of unemployment or staff shortages, people want to know that they work for a good organisation, one of which they can feel proud. Similarly, potential employees will use the ESG report to determine if this is an organisation for whom they want to work. As such, the strategic and potentially value-creating role of ESG reporting becomes clear.

Suppliers and business partners

If a company is considering a long-term partnership or engaging in a significant supplier relationship with a company, then basic due diligence would include a review of the relevant ESG performance. Stronger ESG performers are lower risk companies, and so offer better business relationships.

Consumers

While much of the early literature about sustainability believed that the consumer would drive corporate engagement in sustainability, it is certainly the case that for some products, communicating the sustainability performance of the company is crucial. For large corporate customers, ESG reports will be the expected way to communicate credibly.

Communities and society

As with consumers, communities want to know about the impacts their neighbours are having. The ESG report can be thought of as a way to present the case for the renewal of the social license to operate that an organisation has with its wider stakeholders.

Regulatory authorities

Lastly, regulatory authorities will want to read ESG reports to understand if legislation is being effective, or if there is a need for further intervention.

Crystalbrook Bailey, Australia

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Consumers *and your* **community** *want to see ESG reports to understand that your organisation is* **doing the right thing.**

Why use ESG reporting?

Like sustainability and CSR more generally, there are a lot of claims as to why organisations should transition towards a more sustainable business model.

This section of the report considers the evidence behind some of the claims about whether ESG can deliver the benefits proposed.

What influences ESG performance?

Context

One of the more fundamental aspects to ESG performance is the context in which the company is based. The level of economic development of the country, its legal system and underlying culture set the platform for how an organisation can perform (Cai et al, 2016[6]; Liang and Renneboog, 2017b[7]). For an organisation that operates in more than one country, the effect of a single country is less important.

The size of the organisation and the industry in which it operates is also an important driver of ESG performance (Boffo and Patalano, 2020[8]). Recognising this, some ratings providers focus heavily on scoring companies within their sector, rather than across all organisations. While this provides greater contextual consideration, it risks sectors drifting from the standards achieved more universally and is an important decision for organisations to make in deciding which framework to use for their reporting.

The leadership of the company

A significant amount of research has been undertaken on the effect of the leadership of the firm on its ESG performance.

Evidence shows that if an organisation has board members drawn internationally, then they will likely have exposure to different environmental and social legislation, which is held to serve to improve the ESG performance. Often this will extend beyond the legal minimum standards of the country where the organisation is based. The effect of gender is a common finding in ESG research, with multiple authors showing organisations with female CEOs and greater presence on boards scoring higher on ESG ratings. CEOs with daughters appear better able to project regard for 'others', as does the CEO being married – all producing higher ESG scores. Other evidence shows that younger CEOs are attributed to improved ESG performance.

However, CEO confidence produces a negative relationship with ESG performance. The argument is that over-confident CEOs are less likely to hedge, which produces a riskier firm and so a lower ESG performance (McCarthy et al., 2017[9]).

The evidence on the effect of CEO remuneration is mixed and not conclusive.

6. Cai, Y., Pan, C.H. and Statman, M (2016) Why do countries matter so much in corporate social performance? Journal of Corporate Finance. 41, 591–609.
7. Liang, H. and Renneboog, L (2017) On the foundations of corporate social responsibility. Journal of Finance 72 (2), 853–910.
8. Boffo, R., and Patalano, R (2020) ESG Investing: Practices, Progress and Challenges, OECD Paris https://www.oecd.org/finance/esg-investing.htm
9. McCarthy, S., Oliver, B., Song, S., 2017. Corporate social responsibility and CEO confidence. Journal of Banking and Finance. 75, 280–291.

Table 1 - *Leadership characteristics of the firm*

Multinational board members	Iliev and Roth (2020) [10]
Female CEOs	Borghesi et al. (2014) [11] McGuinness et al. (2017) [12] Cronqvist and Yu (2017) [13] Dyck et al. (2020) [14]
CEOs with daughters	Cronqvist and Yu (2017) [15]
Married CEOs	Hegde and Mishra (2019)[16]
CEO age	Borghesi et al. (2014)[11]
Adapted from Gillan, Koch and Starks (2021)[17]	

Characteristics of the organisation

The nature and direction of the effect of organisational characteristics on ESG performance is disputed. There is debate whether the structure and ownership of an organisation influence ESG performance. Another argument exists that ESG performance attracts different kinds of owners, shareholders, and structures.

Research is mixed regarding institutional ownership. There appears to be evidence that organisations with both the lowest and highest ESG performance tend to have the lowest levels of institutional ownership. The argument runs that institutional ownership encourages improved levels of ESG performance. However, the investment required to be an ESG leader does not produce a return that institutional owners see as worthwhile, and hence the top ESG performers may not have institutional ownership (Borghesi et al., 2014[11]; Nofsinger et al., 2019[18]; Chava, 2014[19]; Fernando et al., 2017[20]; Gillan et al., 2010[17]).

ESG's influence on organisational performance

The multiple metrics, methodologies and approaches to evaluating ESG performance, and the many ways to assess financial success of an organisation, means that trying to determine in simple terms whether organisations that adopt an ESG approach to reporting will be more financially successful is very difficult.

Corporate reputation

Clarity AI (2023) [22] studied over 10,000 controversial incidents over more than 1,500 organisations over a four-year period and determined that ESG-related controversial incidents lead to between 2% and 5% stock underperformance after six months. However, specifically for incidents related to negative environmental impacts, the delta in stock market performance was -8.9%. Clarity AI (2023) argue that such incidences are taken as a sign of poor overall management and/or poor ethics within the organisation, which leads to reduced demand for the stock. Further, dealing with such incidences distracts the organisation from its other objectives, leading to further reduction in productivity and profitability.

10. Iliev, P., Roth, L (2020) Do directors drive corporate sustainability? Unpublished working paper.
11. Borghesi, R., Houston, J.F. and Naranjo, A. (2014) Corporate socially responsible investments: CEO altruism, reputation, and shareholder interests. Journal of Corporate Finance. 26, 164–181.
12. McGuinness, P.B., Vieito, J.P. and Wang, M (2017) The role of board gender and foreign ownership in the CSR performance of Chinese listed firms Journal of Corporate Finance. 42, 75–99.
13. Cronqvist, H. and Yu, F (2017) Shaped by their daughters: executives, female socialization, and corporate social responsibility. Journal of Financial Economics. 126 (3), 543–562.
14. Dyck, A., Lins, K.V., Roth, L. and Wagner, H.F (2019) Do institutional investors drive corporate social responsibility? International evidence. Journal of Financial Economics. 131 (3), 693–714.
15. Cronqvist, H. and Yu, F (2017) Shaped by their daughters: executives, female socialization, and corporate social responsibility Journal of Financial Economics. 126 (3), 543–562.
16. Hegde, S.P. and Mishra, D.R (2019) Married CEOs and corporate social responsibility. Journal of Corporate Finance. 58, 226–246.
17. Gillan, S., Hartzell, J.C., Koch, A. and Starks, L. (2010) Firms' Environmental, Social and Governance ESG Choices, Performance and Managerial Motivation. Unpublished working paper.
18. Nofsinger, J.R., Sulaeman, J. and Varma, A (2019) Institutional investors and corporate social responsibility. Journal of Corporate Finance. 58, 700–725.
19. Chava, S. (2014) Environmental externalities and cost of capital. Management Science. 60 (9), 2223–2247.
20. Fernando, C.S., Sharfman, M.P. and Uysal, V.B. (2017) Corporate environmental policy and shareholder value: following the smart money. Journal of Financial and Quantitative Analysis. 52 (5), 2023–2051.
21. Clarity AI (2023) ESG Controversies Led to a 2% to 5% Stock Underperformance after Six Months. https://clarity.ai/in-the-news/clarity-ai-esg-controversies-led-to-a-2-to-5-stock-underperformance-after-six-months/ Accessed 17th July, 2023

Risk

There is evidence that organisations with strong ESG performance are better able to face risk. In a future with ever more apparent risk, this is a strong argument for adopting a ESG approach to managing risk.

Bannier, Bofinger and Rock, (2019)[21] report that a portfolio of investments in strong performing ESG stocks will produce a negative return over a portfolio with the lowest ESG scores. However, the high ESG portfolio has a lower risk profile. The authors conclude that low ESG performing organisations compensate for the higher risk with higher returns. Interestingly, during the 2008 global financial crisis and through the more recent Covid-19 pandemic there is evidence that higher-performing ESG companies enjoyed lower risk than lower-scoring companies and stronger financial performance (Boffo and Patalano, 2020[8]).

In summary, research shows strong ESG performance leads to both lower legal risk and more favourable settlements from prosecutors. Interestingly, suppliers face lower levels of environmental and social-related lawsuits when their customers have higher ESG performance.

Access to finance

CBI claims that two-thirds of investors take ESG factors into consideration when making an investment decision (British Business Bank, 2023[23]). There is variation within these figures, with evidence that older generations of retail investors are less interested in ESG considerations (Janiaud, 2023[24]). S&P Global Ratings (2023[25]) identifies a link between ESG practices and creditworthiness, while the European Banking Authority is requiring ESG factors to be given consideration through the period of any loan, encouraging organisations to move from short-term to longer-term horizons. Further, as demand from investors for companies with high ESG performance increases, the cost of capital for those companies falls further.

Table 2 - *Major ESG risk*

Systematic risk	El Ghoul et al. (2016) [26] Oikonomou et al. (2012) [27] Albuquerque et al. (2019) [28]
Credit risk	Jiraporn et al. (2014) [29] Seltzer et al. (2020) [30]
Legal risk	Stellner et al. (2015) [31] Schiller (2018) [32] Hong and Liskovich (2015) [33]
Equity cost of capital	El Ghoul et al. (2011)[24] Breuer et al. (2018) [34] Hong and Kacperczyk (2009) [35;36] Chava (2014) [37] Ng and Rezaee (2015) [38]
Adapted from Gillian et al [39]	

22. Bannier, C., Bofinger, Y. and Rock, B (2019) Doing safe by doing good: ESG investing and corporate social responsibility in the U.S. and Europe https://www.econstor.eu/bitstream/10419/200161/1/1668853329.pdf
23. British Business Bank (2023) What is ESG – a guide for businesses. https://www.british-business-bank.co.uk/finance-hub/business-guidance/sustainability/what-is-esg-a-guide-for-smaller-businesses/ Accessed 2nd June, 2023.
24. Janiaud, A (2023) ESG appeal diminishing among UK retail investors, says investment platform https://www.sustainableviews.com/esg-appeal-diminishing-among-uk-retail-investors-says-investment-platform/ Accessed 12th June, 2023.
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26. El Ghoul, S., Guedhami, O., Wang, H. and Kwok, C.C. (2016). Family control and corporate social responsibility. Journal of Bank Finance. 73, 131–146.
27. Oikonomou, I., Brooks, C. and Pavelin, S. (2012) The impact of corporate social performance on financial risk and utility: a longitudinal analysis. Financial Management. 41 (2), 483–515.
28. Albuquerque, R., Koskinen, Y. and Zhang, C. (2019) Corporate social responsibility and firm risk: theory and empirical evidence. Management Science. 65 (10), 4451–4469.
29. Jiraporn, P., Jiraporn, N., Boeprasert, A. and Chang, K. (2014) Does corporate social responsibility (CSR) improve credit ratings? Evidence from geographic identification. Financial Management. 43 (3), 505–531.
30. Seltzer, L., Starks, L.T. and Zhu, Q. (2020) Climate Regulatory Risk and Corporate Bonds. Unpublished working paper.
31. Stellner, C., Klein, C. and Zwergel, B. (2015) Corporate social responsibility and eurozone corporate bonds: the moderating role of country sustainability. Journal of Bank Finance. 59, 538–549.
32. Schiller, C. (2018) Global Supply-Chain Networks and Corporate Social Responsibility. Unpublished working paper.
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37. Chava, S., 2014. Environmental externalities and cost of capital. Management Science. 60 (9), 2223–2247.
38. Ng, A.C. and Rezaee, Z. (2015) Business sustainability performance and cost of equity capital. J. Corp. Finan. 34, 128–149.
39. Gillan, S.L., Koch, A. and Starks, L.S. (2021) Firms and social responsibility: A review of ESG and CSR research in corporate finance. Journal of Corporate Finance. https://doi.org/10.1016/j.jcorpfin.2021.101889

ESG and financial performance

The search for evidence that organisations with stronger ESG performance deliver improved financial performance is the Holy Grail for those wanting to see a business transition to more sustainable models.

Friede and Bassen (2015)[40] conducted a meta-review of over 2,000 studies in the literature on this topic and conclude that almost all studies demonstrate at least a 'non-negative' relationship, with the majority showing a positive relationship between CSR/ESG and corporate financial performance. Specific to organisational performance, the ratings provider MSCI (Giese et al., 2019) [41] determine that there is a positive relationship between ESG specifically, and corporate financial performance while Margolis, Elfenbein and Walsh (2009) [42] also establish there is a positive association between CSR and corporate financial performance.

However, it is important to recognise that the complexity of identifying good financial performance, and good ESG performance means that seeking to conclude a causal relationship is fraught with difficulties and great care needs to be taken.

40. Friede, G., Busch, T. and Bassen, A (2015) ESG and financial performance: aggregated evidence from more than 2000 empirical studies. Journal of Sustainable Finance & Investment, Vol. 5/4, pp. 210-233, http://dx.doi.org/10.1080/20430795.2015.1118917.
41. Giese, G. et al. (2019) Foundations of ESG Investing: How ESG Affects Equity Valuation, Risk, and Performance. The Journal of Portfolio Management, Vol. 45/5, pp. 69-83, http://dx.doi.org/10.3905/jpm.2019.45.5.069.
42. Margolis, J., H. Elfenbein and Walsh, J (2009) Does it Pay to Be Good...And Does it Matter? A Meta-Analysis of the Relationship between Corporate Social and Financial Performance, SSRN Electronic Journal, http://dx.doi.org/10.2139/ssrn.1866371.

SCP Mendocino Inn and Farm, United States

> **The complexity** *of identifying* **good financial performance, and good ESG** *performance means that seeking to conclude a causal relationship is* **fraught with difficulties.**

Where is ESG going in the future?

Consolidation of measurement and reporting frameworks

While it is certainly the case that there is a challenge with the certainty of ESG scores, it is also fair to point out that the established financial ratings agencies have suffered finding predictability, most notably during the 2008 financial crisis. ESG ratings and metrics are much younger than financial credit ratings, so there is much catching up to do in the way they measure and how they correlate with wider financial performance and the expectations of society. However, it is no surprise that there is much work underway, particularly focusing on agreeing consistent definitions, methodologies and disclosures.

ESG ratings for an organisation correlate poorly across the major frameworks because of the lack of comparability in metrics, weighting and judgements used to determine the score. Reviewing 'best-in-class' evaluation also makes comparisons across industries and frameworks difficult.

There is value in there being core metrics common across all industries and reporting frameworks, but it is a useful question for all industries to consider whether there is value in combining these common metrics to inform industry-specific metrics.

Topics of increasing emphasis

As ESG reporting matures, it also widens in its scope and identifying material issues for organisations and the topics material to different geographies will become more apparent. Reflecting the breadth of the United Nations Sustainable Development Goals, the issues that rise in importance will be difficult to predict in advance.

The need to prevent loss of biodiversity, and growing unease at executive remuneration are surfacing as the focus of particular attention at present.

Following the Kunming-Montreal Global Biodiversity Framework agreed at COP15 in 2022, the Science Based Targets Network that developed the targets and methodology for assessing progress towards reducing carbon emissions, has launched targets for corporate action on nature, starting with freshwater and land. Target 15 of the Montreal Framework requires all large organisations and financial institutions to assess and disclose nature-related risks, dependencies and impacts. The first validation of companies is expected in 2024. The new EU Nature Restoration Law will require member countries to set targets to restore biodiversity and degraded ecosystems. The Taskforce for Nature-Related Financial Disclosures will also launch its framework to provide more information on nature-related risks and opportunities in September 2023. Hence, firms with products causing deforestation in their supply chain risk significant fines and divestment from funds under this array of new legislation.

Directors' remuneration seems to be more problematic than other issues to address. This topic speaks to transparency in an organisation, the inequity in our society and our discomfort in discussing and disclosing these differences.

Similarly, there is growing pressure from the EU CSDDD to link ESG/sustainability performance in the future with either direct, or variable pay for company directors. If ESG is to be normalised, then we should expect to see Director remunerations linked to sustainability performance in the same way that it is linked to financial performance. Such a step shows corporate maturity in the process of collecting and measuring sustainability data, leadership in tackling sustainability within an organisation and accountability for progress.

Measuring scope 3 emissions has been largely put to one side while organisations focus on the immediate challenge of measuring and reducing their emissions from scopes 1 & 2. Of course, if all organisations decarbonise their scopes 1 & 2 emissions, then there would be no scope 3 emissions. However, global inequalities, access to finance and issues of climate justice determine that wealthier organisations will need to take the lead in helping others to decarbonise. As such, scope 3 emissions are likely to become more difficult to delay the measurement and management of, and ESG reports will need to show this issue has been given due consideration.

Scope 1 emissions	Scope 2 emissions	Scope 3 emissions
The direct emissions from your business. These are within your control like the gas you use to run your hot-water system or the fuel for driving your bus or boat.	The indirect emissions from your business such as the energy you purchase from the grid.	The indirect emissions generated by your guests and supply chain, for example, external laundry providers, transportation of produce, and guest travel to and from your business.

Nature loss and business

Nature loss poses both risks and opportunities for business, now and in the future. More than half of the world's economic output – US$44tn of economic value generation – is moderately or highly dependent on nature (TNFD 2023)[43]. UNFAO estimates that more than 420million hectares of forest were lost to deforestation between 1990 and 2020[44]. Consumption within the EU is responsible for more than 10% of the global deforestation. Palm oil and soy account for more than two-thirds of deforestation.

43. TNFD (2023) https://tnfd.global/ Accessed 17th July, 2023

44. UNFAO (2023) Global Forest Resources Assessment. https://green-business.ec.europa.eu/news/emas-and-green-claims-initiative-2023-04-12_en Accessed 17th July, 2023

Greenwashing

Greenwashing, greenhushing, social washing are increasingly common phrases that reflect the growing trend for civil actions to be brought against organisations where there is a gap between their claims and their actions, or where their actions are not sufficient to meet social expectations. With the increasing importance of sustainability claims for investors, the risk of making an untrue claim that is considered material by investors is also growing. This can relate to the provision, or omission of information. Claims about future performance are seen to be most susceptible to greenwashing.

The EU Green Claims Directive introduces rules to assess environmental claims, while the EU CSDDD, which is part of the European Green Deal, provides a civil law instrument to hold companies accountable and liable for environmental degradation and human rights abuses, both within the European Union and outside. The directive allows for class action litigation to be brought forward and has already begun targeting significant companies for their environmental claims.

According to the European Banking Association (2023)[23] environmental and social issues were the most prominent topics subject to greenwashing and within those topics, climate-related and biodiversity topics accounted for the majority of claims. Overall, there has been a clear increase in the volume of greenwashing claims across all industrial sectors. Further, this increase has been seen across all geographic regions. Given the prominence of Net Zero claims by companies, future focus will certainly extend to a company's use of carbon offsets and encourage accurate claims, supported by independent verified measurements.

ESG for SMEs

While larger organisations have responded to the various pressures to begin ESG reporting, there are many smaller organisation yet to begin the process. This is often due to a lack of knowledge, skills and resources.

There is evidence that the scoring frameworks for ESG tend to be advantageous to larger organisations, generating higher scores than for those with lower market capitalisations (Boffo and Patalano, 2020[8]). This may be because larger organisations have the resources to allocate to ESG issues and reporting, or it may be due to the methods of measurement themselves.

If ESG is seen to be the way to encourage all organisations to give greater consideration and accountability to wider society, then the ESG frameworks and scoring systems will need to give greater credit for the excellent work smaller organisations undertake. If not, SMEs risk being excluded unless there is a change in approach due to the cost of investing in ESG actions and reporting means.

There is an increase in pressure on the supply chain to change, for larger organisations to meet their responsibilities. This shift in scope 3 emissions reporting requirements is likely to capture SMEs in the process. Sustainability performance will become a necessary element of working with larger organisations. The skills and resource support will become a core differentiator and it is likely that larger organisations will initally bear some of this pressure.

Is a ESG strategy the same as a sustainability strategy?

Just as a set of company accounts are a record of financial performance, so the ESG report of a company records how it has performed across a wider set of measures.

Organisations clearly set their objectives and strategy regarding how their end-of-quarter and end-of-year results will look. Yet, the strategy and energies of the organisation are driven by what it is that they want to achieve, whether that is market share or profitability. In the same way, the sustainability strategy of the company should be set by identifying the specific targets the organisation wishes to achieve. Action should focus on those, then relying on the ESG report to record and reflect their overall progress. With often several dozen indicators for an ESG report it would be impossible for an organisation to meaningfully make progress across such a broad range of issues. To do so would arguably dilute the achievements in the main priorities. Hence, the ESG report should be seen as an important commitment to transparency, accountability and a record of achievement, while the sustainability strategy is the main driver of progress and action.

23. British Business Bank (2023) What is ESG – a guide for businesses. https://www.british-business-bank.co.uk/finance-hub/business-guidance/sustainability/what-is-esg-a-guide-for-smaller-businesses/ Accessed 2nd June, 2023.

8. Boffo, R., and Patalano, R (2020) ESG Investing: Practices, Progress and Challenges, OECD Paris https://www.oecd.org/finance/esg-investing.htm

> An **ESG** *report should be seen as an* **important commitment** *to* **transparency, accountability** *and a* **record of achievement.**

Castell Son Claret, Spain

How to start ESG reporting

An effective ESG report not only showcases ambition, action and impact, it also consolidates performance to provide insight for decision-making, facilitates access to and allocation of resources, and helps develop and refine an effective and strategic approach to sustainable operation.

Any organisation can follow this pathway. Transparent and repeated communication of sustainability efforts and performance helps build trust with stakeholders including investors, suppliers, business partners, guests, employees and community members.

Reporting non-financial ESG performance for the first time can appear daunting. Knowing what, why and how to disclose, and navigating existing and emerging regulatory requirements or disclosure frameworks appears complex. ESG reporting, just like any part of an organisation's sustainability effort, is a journey. The key to effective reporting is founded on genuine and transparent disclosures, especially to increasingly informed target audiences.

Building a team

Consider who in your organisation you need to include in the development of your ESG report and the process to reach the outcomes you are seeking. They will need to be aware of the material issues impacting your organisation including environmental, social and governance. You may wish to involve different stakeholders at different times, various stakeholders may be best included in collecting data, setting goals and targets and communicating across your organisation to drive outcomes that align with ambition.

Knowing what ESG issues are relevant

This requires understanding why an issue is reported (why it is material to the organisation), its scope and boundary, how it is managed, performance over time, and plans for future action in the short, medium and long-term. An ESG report is an extension of a sustainability strategy, which should be guided via a materiality assessment.

This is a risk assessment for non-financial issues that helps an organisation understand its impacts on issues for example your organisation's operational emissions contribution to climate change. While a materiality assessment prioritises issues and creates focus for ESG reporting and a corporate sustainability strategy, organisations without a materiality assessment may still communicate their ESG performance while they formalise strategy and focus their effort with time.

The materiality assessment is best developed through a stakeholder-engaged approach, rather than a traditional internal enterprise risk management approach. For example, the impact of climate change risks on operations.

Understanding purpose and ambition

Understanding purpose refers to why you are reporting in the first place so you can create content and format, a tone that is appropriate to your target audience and to ensure effective communication.

Managing sustainability data across the visitor economy for over three decades gives EarthCheck a unique understanding and familiarity with reported data. We can support the tailoring of analysis to meet stakeholder needs and ESG reporting which shares many of the same metrics.

Using one or more established frameworks relevant to an organisation helps guide ESG reporting by providing context and comparability over time. In addition, applying one or more established frameworks aids compliance and embedding ESG considerations into the wider organisational strategy and decision-making process. As an output organisations can set goals and targets to achieve the outcomes you seek.

EarthCheck supports organisations in identifying relevant metrics under the three pillars of ESG and align content across frameworks as needed for materiality, reporting (e.g. GRI, IFRS - ISSB, SASB, ISO, ESRS), governance (e.g. securities exchange rules), sustainability (e.g. SDG and UNGC), industry (e.g. UNWTO, WTTC), organisation and brand.

Selecting your framework

There are many ESG reporting standards and it can be difficult to know which to choose. Generally, there is no wrong choice, but reporting requires consistency and regularly changing standards should be avoided.

Selection of reporting standards should be based on alignment with business (e.g. SASB, ISO) and ESG (e.g. GRI, ISSB) reporting needs, and the clarity and consistency of disclosures should be prioritised.

Consider what you want to get out of the report to select one that is suited to your needs and outcomes.

The International Sustainability Standards Board (ISSB) published global voluntary sustainability disclosure standards in 2023 based widely on IFRS Accounting Standards used in 140 countries, the Global Reporting Initiative (GRI) and the Taskforce for Climate-related Financial Disclosures (TCFD). These provide a more standardised approach to ESG Reporting across all industries and countries and are a good place to start.

European institutions are required to report under the CSRD according to the European Sustainability Reporting Standards (ESRS). These are more rigorous in demanding climate transition plans aligned with the Paris Agreement to limit global warming to 1.5oC. Rapidly changing regulation can be difficult to navigate and the tourism and hospitality industry is likely to become more regulated over the next decade[45].

A further challenge exists in that no industry-specific standards for tourism presently exist under GRI or ISSB. The UNWTO has provided a framework for disclosures[46] that can be applied to ESG reporting standards. This framework is particularly useful for organisations just starting their reporting journey.

A word of caution, aligning with frameworks such as the SDGs risks becoming a box-ticking exercise without meaningful connection to the 169 sub-targets, and understanding how business data supports national commitments. Carefully consider your approach to avoid allegations of greenwashings, or short-changing the meaningful outcomes you can achieve through a more demanding framework.

45. https://apgreenjobs.ilo.org/resources/environmental-social-and-governance-reporting-in-travel-tourism-trends-outlook-and-guidance/at_download/file1

46. https://www.unwto.org/tourism-statistics/environmental-social-governance-tourism-technical-information

Data collection

Even simple data may prove complex to acquire, verify, visualise and interpret. Data come in many forms, raw or processed, qualitative or quantitative, and a combination of data types may be necessary to curate a compelling and genuine message that demonstrates progress. Your data collection will need to reflect the framework against which you are reporting.

Managing large amounts of data may require investment in systems and processes to collect, measure and manage data. The MyEarthCheck online platform manages a suite of sustainability metrics to make data management simple and mitigate human error. The data collection is aligned with the Greenhouse Gas Protocol, IPCC definitions and is CDP approved. Our certification and benchmarking programme includes third-party audits to verify data and processes, to provide the assurance necessary to avoid greenwashing[47] and align with the Greens Claims Directive by the EU[48].

Looking at the data needed for reporting for the first time may reveal gaps in the data you are collecting. This can present an opportunity to develop an internal methodology process to ensure data quality and availability over time.

Gaps or data that are hard to obtain at this stage, should not prevent disclosure, but rather guide disclosure of future needs and action.

If you are already collecting data, your reporting offers you the opportunity to review and refine your data collection methods.

For organisations starting this process, there is no need to reinvent the wheel or try to do too much. Less is often more: focussing effort is more likely to create a tangible positive impact and improve clarity in reporting.

If you are taking your first steps, it is important to consider that not everything may be possible at first, but new methods, tools and frameworks are emerging to support organisations to achieve disclosure goals. EarthCheck provides the support services to help organisations tackle these challenges, report with clarity in a transparent and genuine manner, and develop a strategic approach for positive impact.

Implementing action

Once you have a baseline of data, you can set your goals and targets then it is time to identify the actions that will support your goals. Consider your processes, reporting over time and legislative requirements.

Communicate your goals and aspirations with staff to gain their buy-in, include any processes required to support outcomes being achieved.

47. https://www.spglobal.com/ratings/en/research/pdf-articles/230608-sustainability-insights-research-carbon-capture-removal-and-credits-pose-challenges-for-companies-101578150
48. https://environment.ec.europa.eu/system/files/2023-03/Proposal%20for%20a%20Directive%20on%20Green%20Claims.pdf

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Given the **prominence of Net Zero claims** *by organisations,* **future focus** *will certainly extend to a company's* **use of carbon offsets** *and encourage accurate claims,* **supported by verified measurement.**

One & Only Reethi Rah, Maldives

Key operational discussions

There is a global movement to improve and align climate-related and non-financial disclosures through recent and upcoming regulation including CSDDD[49] and Corporate Sustainability Reporting Directive (CSRD).

The EU and the United States Securities and Exchange Commission (SEC) draft ruling on climate-related disclosures[50] is driving this change. Here we present some challenges commonly raised by EarthCheck clients under the current frameworks for reporting, with insights on how they may be addressed.

How do we collect relevant data?

We have identified the challenges with data collection, this can also be a time-consuming exercise given the scope and granularity required. It is important to note that non-financial or intangible metrics may require separate measurement and management systems. Accurate and reliable data are important in ESG reporting so setting a consistent, replicable methodology will underpin your success. For those businesses already reporting to the MyEarthCheck software, you have a strong starting position and importantly, understand the importance of structuring a clear data collection method.

Organisations that are unsure what metrics to collect can refer to their chosen reporting standards. Accurate data presentation is important to avoid misleading stakeholders. Data may be presented as absolute or by intensity (per unit area, occupied room or guest night). Intensity disclosures can be influenced by occupancy but value exists in comparing performance between assets or organisations and effective communication (e.g. kg of CO_2 per guest night). However, intensity may distract from progress towards absolute targets such as net-zero emissions or waste. Disclosing both allows stakeholders to understand progress and compare performance. EarthCheck can support you in what metrics are best suited to your framework and methodologies that can be applied to reach the outcomes you are seeking.

Does it need to be complex?

ESG reporting and sustainability in general is an increasingly complex and scientific discipline, requiring a level of rigor and specialisation that traditional tourism and hospitality roles struggle to fulfil.

Comprehensive understanding across the system in which you operate is required to tackle non-financial issues. Each issue presents its own reputational and regulatory risk such as climate change, Scope 3 emissions, supply chains, stakeholder expectations or emerging biodiversity and natural capital demands[51]. Upskilling will become a core part of the future of the industry. EarthCheck is well-positioned to work with you to address your risks, develop your report and upskill your staff to build capacity into the future. Building the skills today will position you well for when reporting is mandatory.

The lack of resources or integration into traditional business strategy can be particularly challenging for SME's and tourism and hospitality stakeholders. This is, in part, the reason why large multinational organisations are leading in ESG reporting progress. Regulation pressures for large organisations are also accelerating change. It is important that we learn from and engage with those early adopters.

49. https://www.responsible-investor.com/landmark-sustainability-due-diligence-directive-passes-european-parliament-vote/
50. https://www.spglobal.com/esg/solutions/getting-ready-for-the-sec-climate-disclosure-rule
51. Following the Kunming-Montreal Global Biodiversity Framework in 2022 https://www.cbd.int/gbf/targets/ (the biodiversity equivalent of the Paris Agreement for climate change).

What opportunities does ESG reporting bring?

The return on investment in systems and processes to collect and manage data may not be immediately tangible and require quantification of time and efficiency. However, ESG performance data can lead to financing opportunities that would otherwise not be accessible. For example, ESG performance data underpinned by EarthCheck has been used to secure a HK$7.5 billion sustainability-linked loan by Langham Hospitality Investments[52]. Such opportunities would not exist without the data and rigor of systems in place to reduce risk.

Increasingly, ESG performance is moving beyond a cost centre or a cost-saving endeavour and towards accessing green bonds and finances, revenue generation and business growth. Elsewhere commercial banking are increasingly referring to sustainability and ESG metrics to support green finance.

Where to from here?

Integrating ESG into broader business strategy requires a shift in organisational culture and the allocation of resources.

Accountability and engagement of boards or executives (e.g. CSDDD[53]) is essential to achieve the progress promised in public disclosures.

The SDGs highlight the importance of partnership, and engaging industry partners to drive meaningful change. EarthCheck can support organisations to navigate, understand and embed tried and tested approaches to identify, manage and report ESG issues strategically and transparently. This will enable the organisation to improve sustainable operations, build trust and credibility, and create shared value.

The pressure to report ESG performance will only grow as regulations become mandatory for all. It is likely that these will rapidly speed up as we near key milestones or deadlines for national and international commitments to the SDGs or Paris Agreement for Climate Change. The sooner organisations begin their ESG learning journey the lower the risk, with inaction being the greatest risk of all.

52. https://earthcheck.org/news/langham-hospitality-investments-signs-new-4%E2%80%90year-sustainability%E2%80%90linked-loan-totalling-hk7-5-billion/
53. https://commission.europa.eu/business-economy-euro/doing-business-eu/corporate-sustainability-due-diligence_en

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Inaction *is the*
greatest risk of all.

Belmond Eagle Island Lodge, Botswana

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